

ASSEMBLY BILL

No. 1628

Introduced by Assembly Member Klehs

February 22, 2005

An act to amend Sections 18662, 18666, and 18668 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 1628, as introduced, Klehs. Taxation: withholding: penalty for failure to withhold.

Existing law requires a withholding agent, as defined, to withhold tax from payments of income derived from California sources and received by nonresident contractors, beneficiaries of estates and trusts, partners, and individual resident and nonresident sellers of California real property. Existing law imposes a penalty on a withholding agent for failure to withhold, calculated based on the amount of tax that the taxpayer failed to pay, not to exceed the amount that should have been withheld by the agent. Under existing law, the penalty can be assessed only after the Franchise Tax Board determines the amount of tax that the taxpayer failed to pay.

This bill would modify the current assessment procedure to permit the Franchise Tax Board to assess a penalty for failure to withhold immediately after a failure to withhold occurs and to base the imposition of that penalty solely on the failure of the agent to withhold rather than on the amount of tax owed by the taxpayer. This bill would also change the amount of penalty to the greater of \$500 or 10% of the amount required to be withheld.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 18662 of the Revenue and Taxation Code is amended to read:

18662. (a) The Franchise Tax Board may, by regulation, require any person, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and any officer or department of the state or any political subdivision or agency of the state, or any city organized under a freeholder's charter, or any political body not a subdivision or agency of the state), having the control, receipt, custody, disposal, or payment of items of income specified in subdivision (b), to withhold an amount, determined by the Franchise Tax Board to reasonably represent the amount of tax due when the items of income are included with other income of the taxpayer, and to transmit the amount withheld to the Franchise Tax Board at the time as it may designate.

(b) The items of income referred to in subdivision (a) are interest, dividends, rents, prizes and winnings, premiums, annuities, emoluments, compensation for services, including bonuses, partnership income or gains, and other fixed or determinable annual or periodical gains, profits, and income.

(c) The Franchise Tax Board may authorize the tax under subdivision (a) to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(d) ~~Any~~ *Unless it is shown that the failure to withhold is due to reasonable cause, any person failing to withhold from any payments any amounts required by subdivision (a) to be withheld is liable for the amount withheld or the amount of taxes due from the person to whom the payments are made to an extent not in excess of the amounts required to be withheld, whichever is greater, unless it is shown that the failure to withhold is due to reasonable cause. subject to a penalty for each failure in the amount equal to the greater of the following:*

(1) *Five hundred dollars (\$500).*

(2) *Ten percent of the difference between the amount withheld and submitted to the Franchise Tax Board and the amount required to be withheld and submitted to the Franchise Tax Board.*

(e) (1) This subdivision applies to any disposition of a California real property interest by:

(A) Any person, other than either of the following:

(i) A corporation, including an entity classified for tax purposes as a corporation under Part 11 (commencing with Section 23001).

(ii) A partnership, as determined in accordance with Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code, including an entity classified as a partnership for tax purposes under Part 10 (commencing with Section 17001).

(B) A corporation, if the corporation immediately after the transfer of the title to the California real property has no permanent place of business in California. For purposes of this subdivision, a corporation has no permanent place of business in California if all of the following apply:

(i) It is not organized and existing under the laws of California.

(ii) It does not qualify with the office of the Secretary of State to transact business in California.

(iii) It does not maintain and staff a permanent office in California.

(2) In the case of any disposition of a California real property interest by a transferor described in paragraph (1), the transferee (including for this purpose any intermediary or accommodator in a deferred exchange) is required to withhold an amount equal to $3\frac{1}{3}$ percent of the sales price of the California real property conveyed.

(3) Notwithstanding any other provision of this subdivision, all of the following shall apply:

(A) No transferee is required to withhold any amount under this subdivision unless the sales price of the California real property conveyed exceeds one hundred thousand dollars (\$100,000).

(B) No transferee (other than an intermediary or an accommodator in a deferred exchange) is required to withhold any amount under this subdivision unless written notification of the withholding requirements of this subdivision has been provided by the real estate escrow person.

(C) (i) No transferee, trustee under a deed of trust, or mortgagee under a mortgage with a power of sale is required to

1 withhold under this subdivision when the transferee has acquired
2 California real property at a sale pursuant to a power of sale
3 under a mortgage or deed of trust or a sale pursuant to a decree of
4 foreclosure or has acquired the property by a deed in lieu of
5 foreclosure.

6 (ii) No transferee is required to withhold under this
7 subdivision when the transferor is a bank acting as trustee other
8 than a trustee of a deed of trust.

9 (D) No transferee (including for this purpose any intermediary
10 or accommodator in a deferred exchange) is required to withhold
11 any amount under this subdivision if the transferee, in good faith
12 and based on all the information of which he or she has
13 knowledge, relies on a written certificate executed by the
14 transferor, certifying, under penalty of perjury, one of the
15 following:

16 (i) (I) The California real property being conveyed is the
17 seller's or decedent's principal residence (within the meaning of
18 Section 121 of the Internal Revenue Code).

19 (II) The last use of the property being conveyed was use by the
20 transferor as the transferor's principal residence within the
21 meaning of Section 121 of the Internal Revenue Code.

22 (ii) (I) The California real property being conveyed is being
23 exchanged, or will be exchanged, for property of like kind
24 (within the meaning of Section 1031 of the Internal Revenue
25 Code), but only to the extent of the amount of the gain not
26 required to be recognized for California income or franchise tax
27 purposes under Section 1031 of the Internal Revenue Code.

28 (II) Subclause (I) may not apply if an exchange does not
29 qualify for nonrecognition treatment for California income or
30 franchise tax purposes under Section 1031 of the Internal
31 Revenue Code, in whole or in part, due to the failure of the
32 transaction to comply with the provisions of Section 1031(a)(3)
33 of the Internal Revenue Code, relating to the requirement that
34 property be identified and that the exchange be completed not
35 more than 180 days after the transfer of the exchanged property.

36 (III) In any case where clause (ii) applies, the transferee
37 (including for this purpose any intermediary or accommodator in
38 a deferred exchange) is required to notify the Franchise Tax
39 Board in writing within 10 days of the expiration of the statutory
40 periods specified in Section 1031(a)(3) of the Internal Revenue

1 Code and thereafter remit the applicable withholding amounts
2 determined under this subdivision in accordance with paragraph
3 (4).

4 (iii) The California real property has been compulsorily or
5 involuntarily converted (within the meaning of Section 1033 of
6 the Internal Revenue Code) and the transferor intends to acquire
7 property similar or related in service or use so as to be eligible
8 for nonrecognition of gain for California income tax purposes
9 under Section 1033 of the Internal Revenue Code.

10 (iv) The transaction will result in either a net loss or a net gain
11 not required to be recognized for California income or franchise
12 tax purposes.

13 (v) The transferor is a corporation with a permanent place of
14 business in California.

15 (E) (i) In the case of any transaction otherwise subject to this
16 subdivision that qualifies as an “installment sale” (within the
17 meaning of Section 453(b) of the Internal Revenue Code) for
18 California income tax purposes, the provisions of this subdivision
19 may, upon the irrevocable written election of the transferee, be
20 separately applied to each principal payment to be made under
21 the terms of the installment sale agreement between the parties.

22 (ii) For purposes of clause (i), subparagraph (A) of paragraph
23 (3) does not apply to each individual payment to be received
24 under the terms of the installment sale agreement.

25 (iii) The election under this subparagraph shall be made at the
26 time, and in the form and manner, specified by the Franchise Tax
27 Board in forms and instructions, except that the form shall, at a
28 minimum, include the requirement specified in clause (iv) of this
29 subparagraph.

30 (iv) The election under this subparagraph is valid only if the
31 transferee agrees to withhold and remit from each installment
32 payment the amount specified under this subdivision in the form
33 and manner, and at the time, specified in paragraph (4).

34 (4) (A) Amounts withheld and payments made in accordance
35 with this subdivision shall be reported and remitted to the
36 Franchise Tax Board in the form and manner and at the time
37 specified by the Franchise Tax Board. Notwithstanding the
38 foregoing, funds withheld on individual transactions by real
39 estate escrow persons may, at the option of the real estate escrow
40 person, be remitted by the 20th day of the month following the

1 close of escrow for the individual transaction, or may be remitted
2 on a monthly basis in combination with other transactions closed
3 during that month.

4 (B) The transferor shall submit a copy of the written certificate
5 specified in subparagraph (D) of paragraph (3), executed by the
6 transferor, to the Franchise Tax Board upon request.

7 (5) For purposes of this subdivision, “California real property
8 interest” means an interest in real property located in California
9 and defined in Section 897(c)(1)(A)(i) of the Internal Revenue
10 Code.

11 (6) For purposes of this subdivision, “real estate escrow
12 person” means any of the following persons involved in the real
13 estate transaction:

14 (A) The person (including any attorney, escrow company, or
15 title company) responsible for closing the transaction.

16 (B) If no person described in subparagraph (A) is responsible
17 for closing the transaction, then any other person who receives
18 and disburses the consideration or value for the interest or
19 property conveyed.

20 (7) (A) Unless the real estate escrow person provides
21 “assistance,” it shall be unlawful for any real estate escrow
22 person to charge any customer for complying with the
23 requirements of this subdivision.

24 (B) For purposes of this paragraph, “assistance” includes, but
25 is not limited to, helping the parties clarify with the Franchise
26 Tax Board the issue of whether withholding is required under
27 this subdivision or, upon request of the parties, withholding an
28 amount under this subdivision and remitting that amount to the
29 Franchise Tax Board.

30 (C) For purposes of this paragraph, “assistance” does not
31 include providing the written notification of the withholding
32 requirements of this subdivision.

33 (D) In a case where the real estate escrow person provides
34 “assistance” in complying with the withholding requirements of
35 this subdivision, it shall be unlawful for the real estate escrow
36 person to charge any customer a fee that exceeds forty-five
37 dollars (\$45).

38 (8) For purposes of this subdivision, “sales price” means the
39 sum of all of the following:

1 (A) The cash paid, or to be paid, but excluding for this purpose
2 any stated or unstated interest or original issue discount (as
3 determined under Sections 1271 through 1275, inclusive, of the
4 Internal Revenue Code).

5 (B) The fair market value of other property transferred, or to
6 be transferred.

7 (C) The outstanding amount of any liability assumed by the
8 transferee or to which the California real property interest is
9 subject immediately before and after the transfer.

10 (9) The Franchise Tax Board may prescribe, by forms,
11 instructions, published notices, or regulations, any requirements
12 necessary for the efficient administration of this subdivision
13 relating to the treatment of “de minimus” amounts otherwise
14 required under this section.

15 (f) Whenever any person has withheld any amount pursuant to
16 this section, the amount so withheld shall be held in trust for the
17 State of California. The amount of the fund shall be assessed,
18 collected, and paid in the same manner and subject to the same
19 provisions and limitations (including penalties) as are applicable
20 with respect to the taxes imposed by Part 10 (commencing with
21 Section 17001), Part 11 (commencing with Section 23001), or
22 this part.

23 (g) Withholding is not required under this section with respect
24 to wages, salaries, fees, or other compensation paid by a
25 corporation for services performed in California for that
26 corporation to a nonresident corporate director for director
27 services, including attendance at a board of directors’ meeting.

28 (h) In the case of any payment described in subdivision (g),
29 the person making the payment shall do each of the following:

30 (1) File a return with the Franchise Tax Board at the time and
31 in the form and manner specified by the Franchise Tax Board.

32 (2) Provide the payee with a statement at the time and in the
33 form and manner specified by the Franchise Tax Board.

34 (i) (1) The amendments to this section made by Chapter 488
35 of the Statutes of 2002 apply to dispositions of California real
36 property interests that occur on or after January 1, 2003.

37 (2) In the case of any payments received on or after January 1,
38 2003, pursuant to an installment sale agreement relating to a
39 disposition occurring before January 1, 2003, the amendments to

1 this section made by Chapter 488 of the Statutes of 2002 do not
2 apply to those payments.

3 SEC. 2. Section 18666 of the Revenue and Taxation Code is
4 amended to read:

5 18666. (a) Section 1446 of the Internal Revenue Code shall
6 apply to the extent that the amounts represent income from
7 California sources, except as otherwise provided.

8 (b) (1) The rate of tax referred to in Section 1446(b)(2)(A) of
9 the Internal Revenue Code shall be the maximum tax rate
10 specified in Section 17041, rather than the rate specified in
11 Section 1 of the Internal Revenue Code.

12 (2) The rate of tax referred to in Section 1446(b)(2)(B) of the
13 Internal Revenue Code shall be the rate specified in Section
14 23151, 23181, or 23183, as applicable, rather than the rate
15 specified in Section 11 of the Internal Revenue Code.

16 (c) *The penalty for failure to withhold any amount required to*
17 *be withheld under this section shall be determined in accordance*
18 *with subdivision (a) of Section 18668.*

19 SEC. 3. Section 18668 of the Revenue and Taxation Code is
20 amended to read:

21 18668. (a) Every person required under this article to deduct
22 and withhold any tax is hereby made liable for that tax, to the
23 extent provided by this section and, insofar as they are not
24 inconsistent with this article, all the provisions of this part
25 relating to penalties, interest, assessment, and collections shall
26 apply to persons subject to this part, and for these purposes any
27 amount required to be deducted and paid to the Franchise Tax
28 Board under this article shall be considered the tax of the person.
29 ~~Any~~ *Unless it is shown that the failure to withhold is due to*
30 *reasonable cause, any person who fails to withhold from any*
31 *payments any amount required to be withheld under this article is*
32 ~~liable for the amount withheld or the amount of taxes due from~~
33 ~~the taxpayer to whom the payments are made but not in excess of~~
34 ~~the amount required to be withheld, whichever is more, unless it~~
35 ~~is shown that the failure to withhold is due to reasonable cause.~~
36 *subject to a penalty for each failure in the amount equal to the*
37 *greater of the following:*

38 (1) *Five hundred dollars (\$500).*

39 (2) *Ten percent of the difference between the amount withheld*
40 *and submitted to the Franchise Tax Board and the amount*

1 *required to be withheld and submitted to the Franchise Tax*
2 *Board.*

3 (b) If any amount required to be withheld under this article is
4 not paid to the Franchise Tax Board on or before the due date
5 required by regulations, interest shall be assessed at the adjusted
6 annual rate established pursuant to Section 19521, computed
7 from the due date to the date paid.

8 (c) Whenever any person has withheld any amount pursuant to
9 this article, the amount so withheld shall be held to be a special
10 fund in trust for the State of California.

11 (d) In lieu of the amount provided for in subdivision (a),
12 unless it is shown that the failure to withhold is due to reasonable
13 cause, whenever any transferee is required to withhold any
14 amount pursuant to subdivision (e) of Section 18662, the
15 transferee is liable for the greater of the following amounts for
16 failure to withhold only after the transferee, as specified, is
17 notified in writing of the requirements under subdivision (e) of
18 Section 18662:

19 (1) Five hundred dollars (\$500).

20 (2) Ten percent of the amount required to be withheld under
21 subdivision (e) of Section 18662.

22 (e) (1) Unless it is shown that the failure to notify is due to
23 reasonable cause, the real estate escrow person is liable for the
24 amount specified in subdivision (d), when written notification of
25 the withholding requirements of subdivision (e) of Section 18662
26 is not provided to the transferee (other than a transferee that is an
27 intermediary or accommodator in a deferred exchange) and the
28 California real property disposition is subject to withholding
29 under subdivision (e) of Section 18662.

30 (2) The real estate escrow person shall provide written
31 notification to the transferee (other than a transferee that is an
32 intermediary or accommodator in a deferred exchange) in
33 substantially the same form as follows:

34
35 “In accordance with Section 18662 of the Revenue and
36 Taxation Code, a buyer may be required to withhold an amount
37 equal to $3\frac{1}{3}$ percent of the sales price in the case of a disposition
38 of California real property interest by either:

1 1. A seller who is an individual, trust, or estate or when the
2 disbursement instructions authorize the proceeds to be sent to a
3 financial intermediary of the seller, OR

4 2. A corporate seller that has no permanent place of business
5 in California immediately after the transfer of title to the
6 California real property.

7 The buyer may become subject to penalty for failure to
8 withhold an amount equal to the greater of 10 percent of the
9 amount required to be withheld or five hundred dollars (\$500).

10 However, notwithstanding any other provision included in the
11 California statutes referenced above, no buyer will be required to
12 withhold any amount or be subject to penalty for failure to
13 withhold if:

14 1. The sales price of the California real property conveyed
15 does not exceed one hundred thousand dollars (\$100,000), OR

16 2. The seller executes a written certificate, under the penalty of
17 perjury, certifying that the seller is a corporation with a
18 permanent place of business in California, OR

19 3. The seller, who is an individual, trust, estate or a
20 corporation without a permanent place of business in California
21 executes a written certificate, under the penalty of perjury, of any
22 of the following:

23 A. The California real property being conveyed is the seller's
24 or decedent's principal residence (within the meaning of Section
25 121 of the Internal Revenue Code).

26 B. The last use of the property being conveyed was use by
27 the transferor as the transferor's principal residence within the
28 meaning of Section 121 of the Internal Revenue Code.

29 C. The California real property being conveyed is or will be
30 exchanged for property of like kind (within the meaning of
31 Section 1031 of the Internal Revenue Code), but only to the
32 extent of the amount of gain not required to be recognized for
33 California income tax purposes under Section 1031 of the
34 Internal Revenue Code.

35 D. The California real property has been compulsorily or
36 involuntarily converted (within the meaning of Section 1033 of
37 the Internal Revenue Code) and that the seller intends to acquire
38 property similar or related in service or use so as to be eligible
39 for nonrecognition of gain for California income tax purposes
40 under Section 1033 of the Internal Revenue Code.

1 E. The California real property transaction will result in a loss
2 or a net gain not required to be recognized for California income
3 tax purposes.

4 The seller is subject to penalty for knowingly filing a
5 fraudulent certificate for the purpose of avoiding the withholding
6 requirement.”

7 (3) The real estate escrow person is not liable under this
8 subdivision if the tax due as a result of the disposition of
9 California real property is paid by the original or extended due
10 date of the transferor’s return for the taxable year in which the
11 disposition occurred.

12 (4) The real estate escrow person or transferee is not liable
13 under paragraph (1) or subdivision (d), if the failure to withhold
14 is the result of his or her reliance, based on good faith and on all
15 the information of which he or she has knowledge, upon a
16 written certificate executed by the transferor under penalty of
17 perjury pursuant to subparagraph (D) of paragraph (3) of
18 subdivision (e) of Section 18662.

19 (5) Any transferor who for the purpose of avoiding the
20 withholding requirements of subdivision (e) of Section 18662
21 knowingly executes a false certificate pursuant to that section is
22 liable for twice the amount specified in subdivision (d).

23 (f) The amount of tax required to be deducted and withheld
24 under this article shall be assessed, collected, and paid in the
25 same manner and subject to the same provisions and limitations
26 (including penalties) as are applicable with respect to the taxes
27 imposed by Part 10 (commencing with Section 17001) or Part 11
28 (commencing with Section 23001).